



A world powered
by clean energy

Xebec Adsorption Inc.

**Management's Discussion and Analysis
For the three-month periods ended March 31, 2013**

May 9, 2013

Additional information relating to the Company can be found on SEDAR at www.sedar.com.

1. ABOUT THIS MANAGEMENT DISCUSSION AND ANALYSIS

The following Management's Discussion and Analysis ("MD&A") provides a review of the results of operations, financial conditions and cash flows of Xebec for three-month period ended March 31, 2013. This discussion should be read in conjunction with the information contained in the Company's unaudited consolidated financial statements and related notes for the first quarter of 2013, as well as with the audited consolidated financial statements and related notes for the year ended December 31, 2012. Additional information, including our annual information form (AIF), can be found on SEDAR at www.sedar.com.

The financial information presented herein has been prepared on the basis of International Financial Reporting Standards (IFRS) for financial statements and is expressed in Canadian dollars unless otherwise stated.

In this MD&A, unless otherwise indicated or required by the context, "Xebec", "the Company", "we", "us", "our", "our Company", "the Group" and "our Group" designate, as the case may be, Xebec Adsorption Inc. or Xebec Adsorption Inc. and its subsidiaries. The Company's other subsidiaries are designated as follows: "Xebec SEA" for Xebec Adsorption South East Asia PTE. Ltd. and "Xebec Shanghai" for Xebec Adsorption (Shanghai) Co. Ltd. Also, the fiscal year ending December 31, 2012 and those ended December 31 of prior years are sometimes designated by the terms "fiscal 2012", "fiscal 2011" and so on.

The information contained in this MD&A and certain other sections of this report also includes some figures that are not performance measures consistent with IFRS, such as earnings (loss) before amortization, financial expenses, other items and income taxes ("EBITDA"). The Company uses EBITDA because this measure enables management to assess the Company's operational performance. This measure is a widely accepted financial indicator of a company's ability to repay and assume its debt. Investors should not regard it as an alternative to operating revenues or cash flows, or a measure of liquidity. As this measure is not established in accordance with IFRS, it might not be comparable to those of other companies.

The information contained in this Management's Report accounts for any major event occurring up to May 9, 2013, the date on which the Board of Directors approved the consolidated financial statements and Management's Report for the period ended March 31, 2013. It presents the Company's status and business context as they were, to management's best knowledge, at the time this report was written.

FORWARD-LOOKING STATEMENTS

This Management Discussion and Analysis ("MD&A") contains forward-looking statements, including statements regarding the future success of the Company's business, technology, and market opportunities. Forward-looking statements typically contain words such as "believes", "expects", "anticipates", "continues", "could", "indicates", "plans", "will", "intends", "may", "projects", "schedules", "would" or similar expressions suggesting future outcomes or events, although not all forward-looking statements contain these identifying words. Examples of such statements include, but are not limited to, statements concerning: (i) actions expected to be undertaken to achieve the Company's strategic goals; (ii) the key market drivers impacting the Company's success; (iii) intentions with respect to future biogas development work; (iv) expectations regarding business activities and orders that may be received in fiscal 2013 and beyond; (v) trends in, and the development of, the Company's target markets; (vi) the Company's market opportunities; (vii) the benefits of the Company's products, (viii) the intention to enter into agreements with partners; (ix) future outsourcing; (x) expectations regarding competitors; (xi) the expected impact of the described risks and uncertainties; (xii) intentions with respect to the payment of dividends; (xiii) the management of the Company's liquidity risks in light of the prevailing economic conditions; (xiv) the Company's cost reduction plan; and (xv) the search for additional financing over the next months. These statements are neither promises nor guarantees, but involve known and unknown risks and uncertainties that may cause the

Company's actual results, level of activity or performance to be materially different from any future results, levels of activity or performance expressed in or implied by these forward-looking statements. These risks include, generally, risks related to revenue growth, operating results, industry and products, technology, competition, the economy and other factors described in detail in Xebec's Annual Information Form for the year ended December 31, 2012 under the heading "Risk Factors" which is available on SEDAR at www.sedar.com and on Xebec's website at www.xebecinc.com.

Although the forward-looking statements contained herein are based upon what management believes to be current and reasonable assumptions, the Company cannot assure readers that actual results will be consistent with these forward-looking statements. Examples of such assumptions include, but are not limited to: (i) trends in certain market segments and the economic climate generally; (ii) the pace and outcome of technological development; (iii) the identity and expected actions of competitors and customers; and (iv) the value of the Canadian dollar. The forward-looking statements contained herein are made as of the date of this MD&A and are expressly qualified in their entirety by this cautionary statement. Except to the extent required by law, the Company undertakes no obligation to publicly update or revise any forward-looking statements contained herein.

2. DESCRIPTION OF THE BUSINESS

CORPORATE OVERVIEW

General

Xebec is a Canadian provider of biogas upgrading, natural gas, field gas and hydrogen purification solutions for the clean energy and crude-derived fuels displacement markets. Xebec designs, engineers and manufactures innovative products that transform raw gases into marketable sources of clean energy mainly used as transportation fuel. Xebec is focused on establishing leadership positions in 4 key markets where demand for biogas upgrading, natural gas purification, associated gas purification and hydrogen purification is growing. Headquartered in Blainville (QC), Xebec also operates two manufacturing facilities in Blainville and Shanghai, a Sales office in Vancouver (BC) as well as a sales and distribution network in North America, and Asia. Xebec (www.xebecinc.com) shares trade on the Toronto Stock Exchange ("TSX") under the symbol XBC.



Xebec's products and services are an essential part of a growing industry of transforming raw gases into marketable sources of clean energy.

Xebec's head office is in Blainville, Quebec in a 41,753 square foot manufacturing facility in which 75 people are currently employed. The Blainville operation houses corporate finance, sales for natural gas, associated gas and biogas purification products, aftermarket support, global supply chain, operational engineering, manufacturing of gas separation and purification equipment and service and maintenance support.

Xebec's Asian 20,451 square foot manufacturing facility is located in the Song Jiang district of Shanghai, Peoples Republic of ("China"). This facility employs 33 people and is responsible for product engineering and assembly using components manufactured in the greater Shanghai industrial area. The facility also provides shared services including supply chain and

engineering support to Xebec's head office. Xebec China is also responsible for sales of Xebec's products, marketing, technical and after-sales support for the Asian and South East Asian markets.

Xebec opened in the first quarter of 2009 along with Angstrom, a regional sales office in Singapore and the office will be closed during the year. Since January 1st 2013, Xebec sells Xebec's products in South East Asia through Bireme PTE Limited, a reseller owned by a former director of Xebec Singapore. Bireme provides local support and service to the South East Asian customer base including customers in Thailand, Malaysia, Indonesia, the Philippines, Vietnam, Brunei, Sri Lanka, Bangladesh and Pakistan. Bireme is primarily supplied by Xebec China.

Technology and Application

Overview.

Almost all industrial gases, whether they are inert, flammable, acid, reactive, or oxidizing, can be dried using what is commonly known as adsorption technology. Adsorption technology is used to remove targeted impurities or separate bulk mixtures. This technology is used in many industrial gas treatment processes including biogas separation and purification, hydrogen recovery, air separation, and oxygen enrichment for medical applications as well as drying applications for air, natural gas, carbon monoxide, carbon dioxide, sulfur dioxide, acetylene, propylene, propane, and syngas.

Adsorption Technology.

Adsorption is a process that occurs when a gas or liquid (solute) accumulates on the surface of a solid or a liquid (adsorbent) forming a film of molecules or atoms (adsorbate). This process differs from the absorption process, in which a substance diffuses into a liquid or a solid to form a solution. Xebec designs, develops, builds, sells, and services engineered adsorption and filtration products for industrial air and gas purification and separation applications employing the principles of PSA and Temperature Swing Adsorption ("TSA").

Adsorbents are a class of materials that have the property whereby gas molecules adhere to their surface. Because some molecules will adhere preferentially over others, by selecting the right adsorbent material it is possible to selectively remove an impurity from a gas stream. To maximize capacity, adsorbents are made with an extremely high porosity, with the result that for a small quantity of adsorbent material, there is a very high surface area available for the impurities to be adsorbed. Once an adsorbent is laden with adsorbed molecules, it can be regenerated for re use in two ways. The first method is to reduce the pressure from normal operating conditions of 80 pounds per square inch to 160 pounds per square inch down to between 0 and 1 pound per square inch, at which point most of the adsorbed molecules are released. The second method is to regenerate using heat. By raising the adsorbent to temperatures of 200°C or higher, the adsorbed molecules are driven off. The adsorbent must then be cooled down to be ready for the next cycle.

The adsorbents and zeolites used by Xebec differ from conventional adsorbents in that their pore sizes are smaller and more orderly structured. This means that some molecules are physically too large to enter the pore, so that the selectivity for adsorption is determined by which molecules can actually enter the zeolite pore. In this way they act just like a sieve, therefore their common name - molecular sieve. One important property of adsorbents is their ability to remove impurities at very low concentrations. This means they can be used to purify a gas to a very high degree of purification. Certain adsorbents have larger pore sizes and are both used for removal of bulk quantities of impurities since they have a high loading capacity needed when impurity concentrations are high.

The purification of a gas implies the removal of a trace impurity or contaminant. The drying of air can be classified in this category since water molecules, considered as the contaminant in drying

applications, are selectively adsorbed onto an adsorbent material as air passes over it. The impure moist air passes through the adsorbent material and the purified dry air is then released. Once the adsorbent material is saturated with water molecules, the adsorbed water can be released by changing the conditions under which it originally adhered in the first place. This regenerates the adsorbent so it can be used again. The principles of adsorption are not limited to the extraction of water, extending to many other types of gas purification. For instance, if the appropriate adsorbent material is used and other conditions are favorable, it is possible to selectively remove the carbon dioxide from air, to separate nitrogen from oxygen, or to dry any other gas such as natural gas.

Pressure Swing Adsorption (PSA).

Pressure swing adsorption is a widely used technology for the purification of gases. This regeneration process is accomplished by reducing the pressure. At the moderate pressures found in compressed air systems, such as 100 pounds per square inch, an adsorbent can support a certain amount of moisture. When that pressure is dropped to ambient air pressure, the adsorbent can only support a smaller amount of moisture. By swinging the pressure from high to low, it is possible to adsorb large quantities of moisture at the higher pressure, and then release that moisture at the low pressure. This technique is called pressure swing adsorption. By alternating between two adsorbent filled vessels, one vessel being on line and removing moisture at high pressure, and the other off line releasing the trapped moisture at low pressure, it is possible to thoroughly dry a gas.

Temperature Swing Adsorption (TSA).

Another method uses temperature in order to regenerate the adsorbent. At low temperatures, adsorbents can retain significant amounts of water. At temperatures above 200°C, however, adsorbents hold almost none. By swinging the temperature from low to high, it is possible to adsorb large quantities of moisture at a low temperature, such as 40°C, and release it at the high temperature.

Conventional PSA Technology.

Conventional PSA systems used today in industry are made up of four to sixteen large vessels, connected by a complex network of piping and valves to switch the gas flows between the vessels. Despite their widespread use in industry, Xebec believes that conventional PSA systems suffer from a number of inherent disadvantages. These PSA systems typically operate at slow cycle speeds of 0.05 to 0.5 cycles/minute since faster cycle speeds would cause the adsorbent beads to float or fluidize in the vessel, causing the beads to wear and ultimately fail. To meet customer demands for capacity, conventional PSA systems must utilize large vessels to compensate for the slow cycle speeds, leading to higher costs and a large equipment footprint. The use of large vessels also means that these PSA systems are typically erected in the field, increasing installation costs. The network of piping and valves used in large scale PSA systems, with the associated instrumentation and process control equipment, also adds cost to the overall system.

Xebec's licensed PSA Technology.

On March 22, 2012, Xebec has sold and licensed back the technology it has developed to continue the marketing of its products. Management believes that its products solve some of the inherent disadvantages of conventional PSA systems. Xebec's licensed rotary valve technology replaces the complex and bulky network of piping and valves used in conventional PSA systems with two compact, integrated valves. These rotary valves are included in Xebec's advanced purification and separation products, and they speed up (or intensify) the rate at which gas can be flowed into a PSA system that uses adsorbent beads in the separation process. In turn, the process intensification allows the PSA to be reduced in size, requiring smaller vessels (compared to conventional PSAs) to purify a particular volume of product gas. In addition, Xebec has a

license to structured adsorbent material, which avoids the fluidization limitation of beaded adsorbents. Xebec's licensed structured adsorbent and rotary valve technologies are integrated into some of its advanced hydrogen and biogas purification products, which operate at significantly higher cycle speeds (up to 50 cycles/minute) than conventional PSA systems. This results in a direct reduction in the amount of adsorbent material, the size of equipment and the amount of energy required to purify a given volume of feed gas.

Products

Xebec designs, develops, builds, sells, and services a range of biogas purification PSA systems (BGX Solutions), natural gas dryers for natural gas vehicle refueling stations and for natural gas upgrading (NGX Solutions), hydrogen purification PSA systems (H2X Solutions), helium purification PSA systems (SGX Solutions), field gas purification systems (AGX Solutions) and filtration and separation equipment (FSX Solutions).

MARKETS

Xebec mainly targets four key market and business segments focused on gaseous fuels used for transportation:

- 1- Biogas upgrading plants
- 2- Natural gas dehydration for NGV refueling stations
- 3- Hydrogen pressure swing adsorption ("PSA ") for hydrogen recovery
- 4- Associated gas purification

Natural gas dryers for NGV refueling stations



Growing market

- Cost leadership through Chinese manufacturing

Key Customers: Clean Energy, Petrochina, Sinopec, Shell

Biogas upgrading plants



Rapidly growing market

- High recovery, high purity, low energy plants

Key Customers: SEMPRA, Montauk Energy, Halla Engineering, Terasen Gas

Hydrogen purifiers for hydrogen recovery



Evolving market segment

- Market-leading performance for small-capacity hydrogen purifiers
- Syngas purification

Key Customers: HydroChem, Air Liquide, Linde, Iwatani

Associated Gas (Oil & Gas industry)



Evolving market segment

- Market-leading performance for associated gas purification

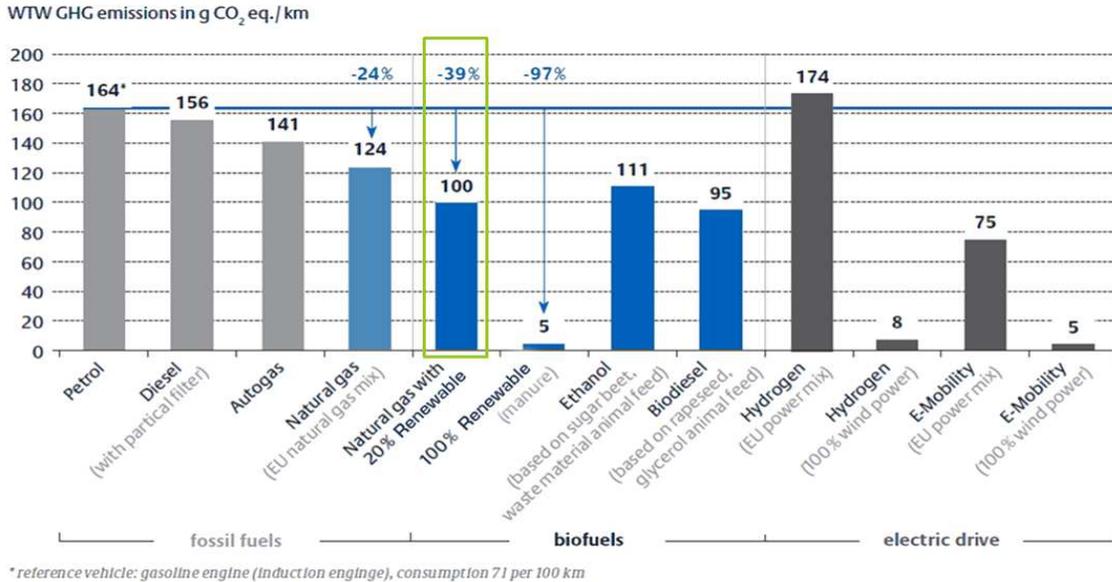
Key Customer: Venocco, Warren

Xebec's current strategy is based on a number of key market drivers and global macro trends driving the demand for Natural Gas and Renewable Gas as a low carbon cleaner energy source of transportation fuel, amongst them are:

- The abundance and low cost of Natural Gas;
- The rising price of oil and need for greater energy independence and security;
- Climate Changes and the urgent need to reduce greenhouse gas emission (GHG);
- Gas flaring reduction targets;
- The growing government commitments to renewable energy;
- Diesel displacement in favor of natural gas; and

- Technological advancements.

These market drivers are anticipated to fuel demand for renewable gas. The low cost of natural gas and biogas drives the demand for solutions aimed at displacing diesel and other crude oil derivatives for power applications for transportation and oil rigs, therefore creating new business opportunities for Xebec.



COMPETITION

Xebec faces competition within its target markets primarily from other manufacturers of biogas purification, natural gas, associated gas and hydrogen purification equipment. The natural gas and biogas purification and separation market has not yet seen considerable consolidation, unlike other industrial or renewable industries. Most competitors of Xebec today are small to medium companies working in niche segments of the natural gas and biogas business.

BGX Solutions: In the emerging biogas purification market, Xebec expects to compete with manufacturers of competing technologies including membrane separation, amine and water wash systems, as well as advanced and conventional adsorption based systems for the purification of biogas. These competitors include, Acricion Technologies Inc., Cirmac International BV, Lackeby Water Group (PURAC), Guild Associates Inc, MT-Biomethan GMBH, Carbotech AC GmbH, Haase Energietechnik AG, Ros Roca Group, Flotech/Greenlane, Yit Vatten Och Misjoteknik, Air Liquide, MalmBerg Water AB and A.R.C. Technologies Corp.

NGX Solutions: In the natural gas dryer market Xebec competes with a number of companies who manufacture gas dryers. These companies include SPX Corp., Parker Hannifin Corporation, Aircel Corp., PSB Industries Inc., Xi'An Unionfilter Purification Equipment Co. Ltd., Zander Aufbereitungstechnik GmbH and Tecno Project Industriale s.r.l.

H2X Solutions: In the hydrogen purification market, Xebec's competition includes Air Liquide, HydroChem, Linde and Air Products.

AGX Solutions: In the associated gas market, Xebec's competition includes several membrane equipment suppliers.

STRATEGY AND OBJECTIVES

Xebec is a global provider which specializes in the design and manufacture of cost-effective, environmentally responsible, purification, separation, dehydration, and filtration equipment for gases and compressed air. Xebec's main product segments are: Biogas Plants for the purification of biogas from agricultural digesters, landfill sites and waste water treatment plants, Natural Gas Dryers for NGV refueling stations, Associated Gas Purification Systems which enables diesel displacement on drilling sites, and Hydrogen Purification Systems for fuel cell and industrial applications.

Xebec's continues to manage its cost structure and working capital, while increasing its revenue. Xebec intends to actively pursue and implement the following measures:

1. Standardize product offering with strong focus on smaller to medium gas flows, where Xebec's solutions offer inherent size and cost benefits;
2. Xebec has monetized some its intellectual property portfolio and created additional liquidity to complete its restructuring plan implemented during its 2011 fiscal year;
3. Enforce and implement tight cost control measures on all general and administrative costs;
4. Maintain regional sales, service and support infrastructure for Xebec's key markets to strengthen Xebec's sales abilities and support products and systems in the market place;
5. Execution and operational excellence, allowing Xebec to deliver products and solutions at the best price, on time and on budget while meeting or exceeding targeted gross margins;
6. Leverage key relationships with leading channel partners and project developers to penetrate target markets;
7. Continue to proactively address and manage its liquidity and working capital requirements. Xebec's delivery cycle for gas plants can be 8 to 12 months which put constraints on its working capital. Xebec is currently reviewing its product design in order to supply a more competitive offering.

RECENT DEVELOPMENTS

On November 12, 2012 Xebec announced that Mr. Patrick Palerme joined the Company's Board of Directors.

On October 23, 2012, The Company received additional proceeds of \$1.0 million pursuant to its intellectual property transaction of March 22, 2012. The Company expects to receive further payments over the next 18 months, upon achievement of certain conditions

On October 3, 2012, The Company received two orders valued at approx. \$1.0 million for two high pressure natural gas dehydration and purification units from two Canadian customers. Those units are aimed at industrial scale diesel and heavy fuel oil displacement

CURRENT BACKLOG

The order backlog is calculated considering contracts received and considered as firm orders.

Current backlog as of

Product Line:	May 9, 2013	April 1, 2013	November 5, 2012	August 2, 2012
In million of \$				
Natural Gas Dryers	3.3	2.5	3.3	2.5
Gas Purification	1.9	4.8	8.2	9.7
Associated Gas	-	0.2		
Others	1.3	1.0	0.3	0.9
Consolidated Backlog	6.5	8.5	11.8	13.1

Major projects included in the current backlog:

North America

Name	Type	Location	Commissioning
Irving Oil Ltd	Natural gas upgrading	New Brunswick, Canada	H1-2013
Primoris	Associated gas upgrading	California, United States	H1-2013
Heritage gas	Natural gas upgrading	Nova Scotia, Canada	H1-2013
Nuvera	PSA System	Massachusetts, United States	H2-2013

Europe:

Name	Type	Location	Commissioning
Verdemobil	PSA System	France	H2-2013

Asia

Name	Type	Location	Commissioning
Grasim Industries limited	PSA System	India	H1-2013
Deok-Yang Company Ltd	PSA System	South Korea	H1-2013
Potlatch Inc.	Biogas upgrading plant	South Korea	H1-2013
Golden Green	Biogas upgrading plant	China	H2-2013
Golden Green #2	Biogas upgrading plant	China	H1-2014

3. SELECTED CONSOLIDATED QUARTERLY INFORMATION

Three-Month Periods Ended March 31, 2013 and 2012

(in million of \$, except per-share amounts) *(unaudited)*

	Three months ended	
	March 31,	
	2013	2012
Revenues	3.8	1.5
Gross margin	9.9%	-18.3%
EBITDA	(1.0)	4.2
Net income (loss)	(1.1)	3.2
Net income (loss) per share - basic (\$/share)	(0.03)	0.08
Net income (loss) per share - diluted (\$/share)	(0.03)	0.08

Balance Sheet Data	March 31	December 31
	2013	2012
Total assets	9.2	9.7
Shareholder's equity	0.6	1.7
Total long-term debt	1.3	1.3
Cash, cash equivalents	1.2	1.3

4. OPERATING RESULTS

Analysis of Consolidated Operating Results for the First Quarter of 2013 Compared with the First Quarter of 2012

Consolidated Revenues by Product Line *(unaudited)*

In millions of \$	Three months ended	
	March 31,	
	2013	2012
Gas purification	1.6	0.5
Natural gas dryers	1.0	0.4
Compressed gas filtration	1.0	0.2
Engineering services	-	0.4
Associated Gas	0.2	-
Total	3.8	1.5

Consolidated revenues for the first quarter of 2013 grew by \$2.3 million or 153.3% to \$3.8 million. This growth is due mainly to the \$1.1 million or 220.0% increase in sales of gas purification units. The Company recognized revenue for two major projects this quarter for gas purification compared to only one last year. All product lines showed an increased in revenues this quarter compared to the last fiscal year.

Operating profit margin (unaudited)

In millions of \$	Three months ended March 31,	
	2013	2012
Revenues	3.8	1.5
Cost of Goods Sold	3.4	1.8
Gross Profit*	0.4	(0.3)
Gross Profit Margin (%)	9.9%	-18.3%

* Gross Profit is a non-IFRS financial measure.

The **operating profit margin** for the first quarter of 2013 stood at 9.9%, up by 28.2% for the first quarter of 2012. The improvement versus the same period last year is mostly explained by the increase in volume for sale. The margins were affected negatively by a \$200,000 provision on the Golden Green projects. Management is currently seeking to renegotiate the contracts.

Selling and administrative expenses for first quarter of 2013 increased by \$0.3 million or 23.9% to \$1.4 million. During the first quarter of 2012, employees were working on a reduced hours schedule until the IP transaction that occurred March 22, 2012.

Research and development expenses, net of research and tax credits for the first quarter of 2013 remains stable at \$0.06 compared to \$0.03 million during the first quarter of 2012.

EBITDA (unaudited)

In millions of \$	Three months ended March 31,	
	2013	2012
Net income (loss)	(1.1)	3.2
Depreciation of property	-	0.1
Amortization of intangible assets	0.1	0.1
Share-based compensation expense	-	-
Finance cost net	-	0.8
EBITDA (loss)	(1.0)	4.2

* EBITDA is a non-IFRS financial measure.

We report on our EBITDA (Income from operations before depreciation and amortization and special charges). EBITDA is not a performance measure defined under IFRS and is not considered an alternative to income from operations or net (loss) earnings in the context of measuring a company's performance. EBITDA does not have a standardized meaning and is therefore not likely to be comparable with similar measures used by other publicly traded companies.

EBITDA for first quarter in 2013 declined by \$5.2 million or 123.8% to \$(1.1) million. The decreased is mainly explained by the one-time gain on the disposition of the IP portfolio to Air Products of \$5.4 million in the first quarter of 2012.

Financial net expenses for first quarter of 2013 decreased by \$0.7 million or 96.0% due to the loss on revaluation of \$0.7 million for the Technology Partnerships Canada program due to the settlement agreement between the Company and Industry Canada in the first quarter of 2012.

Net income (loss)

Net loss for the three-month period ended March 31, 2013 was \$1.1 million, or \$0.03 per share, compared to a net income of \$3.2 million, or \$0.08 per share, for the same period in 2012, reflecting a one-time gain on the disposition of the IP portfolio to Air Products of \$5.4 million in the first quarter of 2012, a decrease in financial net expense of \$0.7 million compared to same period last year and an positive gross margin in the first quarter of 2013.

Principal Quarterly Financial Information

(in thousands of \$, except per-share amounts) *(unaudited)*

	2013	2012				2011		
	Q1	Q4	Q3	Q2	Q1	Q4	Q3*	Q2
Revenues	3.8	5.8	3.7	4.2	1.5	2.7	2.9	4.5
Net income (loss)	(1.1)	(0.1)	(0.7)	(0.5)	3.2	(2.0)	1.7	(1.0)
Earnings (loss) per share basic and diluted	(0.03)	(0.03)	(0.02)	(0.01)	0.08	(0.02)	0.02	(0.03)

*restated

Given the nature of Xebec's business, there are no apparent seasonal or other discernible trends at this time.

5. FINANCIAL POSITION

Analysis of Principal Cash Flows for the First Quarter 2013 (unaudited)

Cash flow from (used in)	Three months ended		
	March 31,		
in millions of \$	2013	2012	Change
Operating activities	(0.5)	(1.9)	1.4
Investing activities	0.3	8.4	(8.1)
Financing activities	0.2	(1.4)	1.6

Operating activities in the first quarter of 2013 used \$0.5 million of cash, compared to \$1.9 million for the same period in 2012. The decrease in uses of cash is mainly outline as follow: compared to the same period last year, after adjustments for items not requiring cash, the gross margin generated \$0.6 million more, while the selling and administrative expenses required an additional \$0.3 million, non-cash working capital components showed a reduction of \$2.4 million for trade payables, accrued liabilities and other operating liabilities, against an increase of \$1.4 million for trade and other receivables, other operating assets and differed revenues. The decrease of use for trade payables results from the fact that in first quarter last year, many suppliers were paid upon the closing of the IP transaction. The increase of use for receivable reflects the return to normal activities supported revenues 2.5 time those that were realized in first quarter last year.

Investing activities generated \$0.3 million of cash in the first quarter of 2013, compared to a cash inflow of \$8.4 million for the corresponding first quarter of 2012. The decrease is mainly explained by the disposition of the IP assets related to the transaction with Air Products during the first quarter of 2012.

Financing activities in the first quarter of 2013 generated \$0.2 million, compared to cash outflow of \$1.4 million for the same period of 2012. The decrease in use of cash relies to the repayment of the bank loan in the first quarter of 2012 of \$0.5 million while a borrowing of \$0.2 million in the same period of 2013. Furthermore, the decrease in use of cash is also explained by the repayments of \$0.1 million of Investissement Quebec's long term debt and of \$0.8 million on the Government royalty program upon closing of the sale of IP assets to Air Products and the settlement agreement reached with The Technology Partnerships Canada program in March 2012.

As of March 31, 2013, the Company had \$1.2 million of cash on hand, \$0.4 million of bank loan and \$1.3 million of long-term debt outstanding, of which \$0.7 million is due within one year.

Balance Sheet Analysis as at March 31, 2013

Summary Balance Sheet

	March 31 2013	December 31 2012
Current assets	\$ 7.6	\$ 7.6
Long-term assets	1.6	2.1
	\$ 9.2	\$ 9.7
Current liabilities	\$ 7.5	\$ 6.8
Long-term liabilities	1.1	1.2
Shareholders' equity	0.6	1.7
	\$ 9.2	\$ 9.7

The change in the company's assets between March 31, 2013 and December 31, 2012 reflects the renegotiation of the Company's balance of sale which led to a shorter repayment schedule. The change in current liabilities is reflected by the increase of the bank loan of \$0.2 million and the increase of trade payable of \$0.4 million. This increase is explained by the significant progress on long-term projects which reflected positively on the Gas Purification revenues.

As at December 31, 2013 **total assets** amounted to \$9.2 million, down by \$0.5 million from December 31, 2012. **Working capital** stood at \$0.1 million for a current ratio of 1:1 compared with \$0.8 million and a 1.1:1 ratio as at December 31, 2012.

Shareholders' equity totalled \$0.6 million as at March 31, 2013 down by \$1.1 million from December 31, 2012. The change is mainly due to net loss of the first quarter of 2013.

Indebtedness

	March 31 2013	December 31 2012
Bank loans	\$ 0.4	\$ 0.2
Current portion of long-term debt	0.7	0.5
Long-term debt	0.6	0.8
Total indebtedness	\$ 1.7	\$ 1.5

Total interest-bearing debt (bank loans, current portion of long-term debt and long-term debt) amounted to \$1.7 million as at March 31, 2013, up by \$0.2 million from December 31, 2012. This increase is due primarily to the increase of the bank loan.

Credit Facilities

As at March 31, 2013, the Company had a revolving demand facility by way of letters of credit and letters of guarantee amounting to \$1,000,000 with Royal Bank of Canada which bore interest at the Royal Bank's prime rate plus 2.50% per annum and which were limited by certain margin requirements concerning accounts receivable. This credit facility was used up to \$163,125 as at March 31, 2013.

In addition, the Company had access to credit facilities in the amount of \$500,000 with Royal Bank of Canada which were guaranteed by Export Development of Canada and bore interest at the Royal Bank's prime rate plus 2.5% per annum and were limited by certain requirements concerning pre-shipment costs. These credit facilities were used up to \$392,100 as at March 31, 2013.

The bank loan is secured by a first ranking hypothec of \$4,000,000 on all movable property of the Company.

Capital Stock Information

The authorized share capital of the Company consists of an unlimited number of common shares and an unlimited number of preferred shares.

As at March 31, 2013 and May 9, 2013, Xebec had 39,363,867 common shares issued.

Share Purchase Warrants Outstanding

As at March 31, 2013, 10,091,886 Share Purchase Warrants were outstanding and entitle the holder to acquire one Common Share at a price of \$0.45 per share until November 2nd 2015.

The 10,091,886 warrants are subject to an accelerated expiry if, at any time after December 31, 2010, the published closing trade price of the Common Shares on the TSX is equal or superior to \$0.75 for any 20 consecutive trading days, in which event Xebec may give the holder a written notice that the warrants will expire at 5:00 p.m. (Toronto Time) on the 30th day from the receipt of such notice.

Stock Options Outstanding

The Company plan (the "Plan"), which allows for the issuance of stock options, stock appreciation rights, restricted stock, restricted stock units, performance awards and other stock-based awards. Under the Plan, common shares approved for issuance under all stock-based compensation arrangements are limited to the greater of 591,560 or 10% of the common shares issued and outstanding. As at March 31, 2013, the maximum number of common shares available for issuance under all stock-based compensation arrangements is 3,936,387.

Under the terms of the Plan, stock options are granted with an exercise price not less than the volume weighted average trading price of the common shares on the TSX for the five trading days prior to the date of grant. Stock options generally vest quarterly over four years and are exercisable for seven years from the date of grant.

As at March 31, 2013, the Company had 3,383,627 options outstanding under the plan with a weighted average exercise price of \$0.19.

Contractual Commitments

The following table is a summary of the contractual obligations including payments due for each of the next five years and thereafter:

As at March 31, 2013	Payments Due by Period			
	1 year	2 -5 years	Beyond 5 years	Total
Operating leases	0.4	1.2	2.8	4.4
Software licenses agreements	0.1	0.2	-	0.3
Total contractual obligations	0.5	1.4	2.8	4.7

There have been no significant changes in the contractual obligations of the Company since its MD&A for the three and twelve-month period ended December 31, 2012 issued on April 1, 2013.

6. FINANCIAL AND OTHER INSTRUMENTS

Liquidity Risk

The Company has realized an operating loss of \$1,050,077, had cash outflows from operations of \$544,877 for the period ended March 31, 2013 and finished the period with cash amounting to \$1,248,876, working capital of \$115,440 and had access to credit facilities totaling \$1,500,000 of which only \$392,100 has been used. The Company is currently in breach of its TPC agreement but obtained a two months extension. During the fourth quarter of 2012, management undertook various initiatives and developed a plan to manage its operating and liquidity risks in light of

prevailing economic conditions. Management is also currently seeking alternative financings for its operations such as asset-based lending facilities. The Company has prepared a budget for 2013 for which management believes the assumptions are reasonable. Achieving budgeted results is dependent on improving the volume of revenues, delivering on sales and contracts schedules, meeting expected overall operating margin levels and controlling general and administrative costs. Management expects to meet its budget and to have enough liquidity to fund operations to at least beyond December 31, 2013. The Company is thus faced with uncertainties that may have an impact on future operating results and liquidity. These uncertainties include reduced spending in biogas projects reflecting the weakness of the market, fluctuations in foreign currency rates and achieving the Company's business plan goals as mentioned in the previous paragraph, which includes the development of a new business segment. While management believes it has developed planned courses of action to mitigate operating and liquidity risks, there is no assurance that management will be able to achieve its business plan and maintain the necessary liquidity level if events or conditions develop that are not consistent with management's expectations, key budget assumptions for 2013 and planned courses of action. Therefore, the Company may require additional external funding and there is no assurance that it would be successful. It is possible that future changes in capital markets conditions could result in such funding not being available when required or at acceptable costs. The Company is unable to predict the possible effects, if any, of such uncertainties and the potential adjustments to the carrying values of assets and liabilities that could be needed should the Company have insufficient liquidity. Such adjustments could be material.

Credit Risk

Credit risk is the risk of an unexpected loss if a customer or third party fails to meet its contractual obligations. The Company's primary credit risk is its cash and outstanding trade accounts receivable. The carrying amount of its outstanding trade accounts receivable represents the Company's estimate of its maximum credit exposure. The Company regularly monitors its credit risk exposure and takes steps such as employing credit-approval procedures, establishing credit limits, using credit assessments and monitoring practices to mitigate the likelihood of these exposures from resulting in an actual loss. An allowance for doubtful accounts amounting to \$222,563 (2012 – \$232,216) was established, based on prior experience and an assessment of current financial conditions of customers as well as the general economic environment. In the case where an allowance for doubtful accounts provision is recorded and a receivable balance is considered uncollectible, it is written off against the allowances for doubtful accounts. Bad debt expense amounted to \$6,931 for first quarter in 2013 (2012 – \$20,000). As at March 31, 2013, the Company's three largest trade debtors accounted for 27% (11%, 9% and 7%) of the total accounts receivable balance (2012 – 36% (16%, 13% and 7%)).

Currency Risk

Some assets and liabilities are exposed to foreign exchange fluctuations. The Company does not use financial instruments to reduce this risk.

Interest Rate Risk

Interest rate risk is the risk that the fair value or future cash flows of financial instruments will fluctuate as market interest rates change. The Company does not use financial instruments to reduce this risk.

The Company is exposed to interest rate risk on its bank loan, for which the interest rates charged fluctuate based on the bank prime rate. As at March 31, 2013, the short term bank loan amounted to \$392,100 (as at December 31 2012 – \$166,952). If the interest rate on the bank debt had been 50 basis points higher (lower), related to the bank loan as at March 31, 2013, net loss would have been \$349 (2012 – \$625) higher (lower).

7. CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The Company makes estimates and assumptions concerning the future that will, by definition, seldom equal actual results. The following are the estimates and judgments applied by management that most significantly affect the Company's consolidated financial statements. These estimates and judgments have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Inventories

Inventories must be valued at the lower of cost or net realizable value. A write down of the inventory will occur when its estimated market value less applicable variable selling expenses is below its carrying amount. Materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost. This estimation process involves significant management judgment and is based on the Company's assessment of market conditions for its products determined by historical usage, estimated future demand and, in some cases, the specific risk of loss on specifically identified inventory. Any change in the assumptions used in assessing this valuation will impact the carrying amount of the inventory and have a corresponding impact on cost of goods sold.

Impairment of customer relations

The Company performs a test for customer relations impairment when there is any indication whether customer relations has suffered any impairment in accordance with the accounting policy stated in the summary of significant accounting policies of these financial statements. The recoverable amounts of customer relations have been determined based on value-in-use calculations. The value in use calculation is based on a discounted cash flow model. These calculations require the use of estimates and forecasts of future cash flows. Qualitative factors, including strength of customer relationships, degree of variability in cash flows as well as other factors are considered when making assumptions with regard to future cash flows and the appropriate discount rate. The recoverable amount is most sensitive to the discount rate used for the discounted cash flow model and the expected future cash inflows. A change in any of the significant assumptions or estimates used to evaluate customer relations could result in a material change to the results of operations.

Percentage of completion and revenues from long-term production-type contracts

Revenues recognized on long-term production-type contracts reflect management's best assessment, by taking into consideration all information available at the reporting date, of the result on each ongoing contract and its estimated costs. The management assesses the profitability of the contract by applying important judgments regarding milestones marked, actual work performed and estimated costs to complete. Actual results could differ because of these unforeseen changes in the ongoing contracts' models.

Related party transactions

The following table presents a summary of the related party transactions during the period (unaudited):

	For the three-month Ended March 31, 2013 \$	For the three-month Ended March 31, 2012 \$
Marketing and professional services expenses paid to companies controlled by members of the immediate family of an officer	22,658	11,975
Sales to entities controlled by a Company director	17,172	2,747
Accrued interest on loan from a Company director	-	811

These transactions are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

Accounting standards issued but not yet applied

Unless otherwise noted, the following revised standards and amendments are effective to the Company for annual periods beginning on or after January 1, 2013 with earlier application permitted. The Company has not yet assessed the impact of these standards and amendments or determined whether it will early adopt them.

(i) IFRS 9, Financial Instruments, issued in November 2009, is mandatory for accounting periods beginning after January 1, 2015 and addresses classification and measurement of financial assets. It replaces the multiple category and measurement models in IAS 39, Financial Instruments – Recognition and Measurement for debt instruments with a new mixed measurement model having only two categories: amortized cost and fair value through profit or loss. IFRS 9 also replaces the models for measuring equity instruments. Such instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. Where equity instruments are measured at fair value through other comprehensive income, dividends are recognized in profit or loss to the extent that they do not clearly represent a return of investment; however, other gains and losses (including impairments) associated with such instruments remain in accumulated comprehensive income indefinitely.

Requirements for financial liabilities were added to IFRS 9 in October 2010 and they largely carried forward existing requirements in IAS 39, Financial Instruments – Recognition and Measurement, except that fair value changes due to credit risk for liabilities designated at fair value through profit or loss are generally recorded in other comprehensive income. IFRS 9 is applicable to the Company for the year beginning on January 1, 2015, with earlier application permitted.

(ii) IFRS 10, Consolidated Financial Statements, requires an entity to consolidate an investee when it has power over the investee, is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Under existing IFRS, consolidation is required when an entity has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. IFRS 10 replaces SIC 12, Consolidation—Special Purpose Entities, and parts of IAS 27, Consolidated and Separate Financial Statements.

(iii) IFRS 11, Joint Arrangements, requires a venturer to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures will be accounted for using the equity method

of accounting whereas for a joint operation, the venturer will recognize its share of the assets, liabilities, revenue and expenses of the joint operation. Under existing IFRS, entities have the choice to proportionately consolidate or equity account for interests in joint ventures. IFRS 11 supersedes IAS 31, Interests in Joint Ventures, and SIC 13, Jointly Controlled Entities—Non-monetary Contributions by Venturers.

(iv) IFRS 12, Disclosure of Interests in Other Entities, establishes disclosure requirements for interests in other entities such as subsidiaries, joint arrangements, associates and unconsolidated structured entities. The standard carries forward existing disclosures and also introduces significant additional disclosures that address the nature of, and risks associated with, an entity's interests in other entities.

(v) IFRS 13, Fair Value Measurement, is a comprehensive standard for fair value measurement and disclosure for use across all IFRS standards. The new standard clarifies that fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. Under existing IFRS, guidance on measuring and disclosing fair value is dispersed among the specific standards requiring fair value measurements and does not always reflect a clear measurement basis or consistent disclosures.

(vi) IAS 1, Presentation of Financial Statements, has been amended to require entities to separate items presented in other comprehensive income into two groups, based on whether or not items may be recycled in the future. Entities that choose to present other comprehensive income items before tax will be required to show the amount of tax related to the two groups separately.

8. DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROL OVER FINANCIAL REPORTING

Disclosure Controls and Procedures

Our management is responsible for establishing and maintaining disclosure controls and procedures ("DC&P") designed to provide reasonable assurance that the information we are required to disclose in our annual filings, interim filings and other reports (the "reports") filed or submitted under the applicable securities legislation is recorded, processed, summarized and reported within the time periods specified in the applicable securities legislation. DC&P include, without limitation, controls and procedures designed to ensure that the information required to be disclosed by an issuer in the reports filed or submitted under the applicable securities legislation is accumulated and communicated to the issuer's management, including its Chief Executive Officer and Chief Financial Officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

As at March 31, 2013, an evaluation was carried out, under the supervision of and with the participation of our management, including the President and Chief Executive Officer and the Chief Financial Officer, of the design and effectiveness of our disclosure controls and procedures as defined under NI 52-109. This evaluation was based on the framework set forth in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Upon such review, the Chief Executive Officer and the Chief Financial Officer determined that there were material weaknesses in the design of our DC&P. However, the DC&P deficiencies we identified did not result in adjustments to our annual or any interim consolidated financial statements for fiscal 2013 and 2012. We have identified the following material weaknesses:

Entity Level Controls

We did not maintain a completely effective control environment as defined in accordance with COSO control framework. Specifically, we do not have comprehensive procedure manuals to clearly communicate management's and employees' roles and responsibilities in our internal control over financial reporting. To mitigate the risk, management relies heavily on manual procedures and detection controls, management meetings, quarterly reviews of financial statements of our subsidiaries. These manual procedures were performed during the interim periods ended March 30, 2013 and 2012.

Internal Control over Financial Reporting

Our internal control over financial reporting ("ICFR") includes, among others, those policies and procedures that: (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with IFRS, and that our receipts and expenditures are being made only in accordance with authorization of our management; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on our financial statements.

We carried out an evaluation of our ICFR, under the supervision of and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer as to the material weaknesses relating to the design of our ICFR as of March 31, 2013. This evaluation was based on the Internal Control-Integrated Framework issued by the COSO. The evaluation considered the procedures designed to ensure that information required to be disclosed by the Company in reports filed or submitted under the applicable securities legislation is recorded, processed, summarized and reported in the time periods specified in the rules and forms of the applicable securities legislation and communicated to our management as appropriate to allow discussions regarding required disclosure. Upon such review, our Chief Executive Officer and Chief Financial Officer have determined that there existed material weaknesses in the design of our ICFR. The ICFR weaknesses we identified did not result in adjustments to our interim and annual consolidated financial statements for fiscal 2013 and 2012. Following our assessment, we identified the following material weaknesses:

Information Technology General Controls

We did not adequately maintain effective control over access to our accounting system within our accounting department. In addition, the backup tapes were not periodically tested to ensure their accuracy and there is no information technology strategic plan and no business continuity plan. There is also no periodic review performed on the security logs for failed logins. We are actually in the process of implementing controls over program development and program changes.

The potential ability for someone to improperly access and change accounting records is mitigated by the fact that management relies heavily on manual procedures and detection controls, and quarterly reviews of financial statements by management and by the Audit Committee.

Segregation of Duties

We have deficient controls within our accounting department over segregation of duties inherent to the department's size. Specifically, as a result of the limited number of personnel in the accounting department, certain financial personnel had incompatible duties that allowed for the creation, review and processing of certain financial data without independent review and authorization. To mitigate the risk, our management relies heavily on manual procedures and detection controls, regular management meetings, as well as reviews of our financial statements and of our subsidiaries. These manual procedures were performed for the periods ended March

31, 2013 and 2012

Remediation of Material Weaknesses in Internal Control over Financial Reporting and Disclosure Controls

We have initiated the following actions to address the material weaknesses in our DC&P and ICFR identified as of March 31, 2013.

Entity Level Controls

Our Management has taken an active role in responding to the deficiencies identified, including overseeing management's implementation of the remedial measures described below.

Information Technology General Controls

We will implement enhanced information technology policies and procedures specifically with regard to inventory controls and to the system's change management, program development, access over end-of-period process spreadsheets, IT operations and related monitoring. We will implement new procedures that will overcome the accounting system inventory controls and access deficiencies. We will also develop and implement a global information technology strategic plan and a business continuity plan.

Inadequate Segregation of Duties

We will continue to use appropriate measures to restrict or independently monitor systems access and properly assign job roles and responsibilities to employees to ensure the proper segregation of duties where feasible. As the Company grows, we will expand the number of individuals involved in the accounting function.

We realize that some of the above weaknesses are inherent to a company of our size. Nevertheless, we believe in and are committed to establishing rigorous DC&P and ICFR. It will take time to put in place the rigorous controls and procedures desired by our management and Board of Directors. We cannot at this time estimate how long it will take to complete the steps identified above. Our management will continue to evaluate the effectiveness of our overall control environment and will continue to refine existing controls as they, in conjunction with our Audit Committee, Chief Executive Officer and Chief Financial Officer, think necessary. Again, the control deficiencies which we identified did not result in adjustments to our interim and annual consolidated financial statements for the first quarter of 2013 or any previous periods, except for the restatement of our third quarter 2011.

Other than the remediation efforts discussed above and the implementation of the Company's ICFR, there have been no changes in our ICFR that occurred since the beginning of the interim period ended March 31, 2013 that have materially affected or are reasonably likely to materially affect our ICFR. Our management, including our Chief Executive Officer and our Chief Financial Officer, has discussed these issues and remediation efforts with our Audit Committee.

We will provide updates on the remediation plan in our quarterly and annual management's reports.

It should be noted that while our management believes that current disclosure and internal controls and procedures provide a reasonable level of assurance, it cannot be expected that existing disclosure controls and procedures or internal financial controls will prevent all human errors and circumvention or overriding of the controls and procedures. A control system, no matter how well conceived or operated, can provide only reasonable assurance, not absolute, that the objectives of the control system are met.

RISKS AND UNCERTAINTIES

An investment in our securities involves a high degree of risk and should be considered speculative due to the nature of our business and the businesses of our subsidiaries and their current respective stage of development. Before making any decision to purchase or to sell any of our securities, you should carefully consider the complete statement of the risk factors and uncertainties described in the Management's Report and Annual Information Form for fiscal 2012. The Company is pursuing an ongoing risk review and management process.